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November 14, 2006

AGENDA ITEM 8

TO: MEMBERS OF THE HEALTH BENEFITS COMMITTEE

I. SUBJECT: Long-Term Care Program 2005 and Earlier Policies – Proposed Mitigation Plan

II. PROGRAM: Health Program

III. RECOMMENDATION:

? Staff recommends that the Board accept the June 30, 2006 Long-Term Care Program Valuation report as prepared by United Health Actuarial Services.

· Staff recommends that the Board adopt the proposed mitigation plan for 2005 and Earlier Policies to implement an average 33.6 percent premium increase effective July 1, 2007.

· Staff recommends that the Board adopt a one year implementation of the rate increase with moderate cross subsidization across plan designs and age groups.

IV. ANALYSIS:

At the June 2006 meeting of the Health Benefits Committee (Committee), Audit Services was assigned the responsibility to facilitate completion of a parallel valuation based on June 30, 2006, policies-in-force for the Long-Term Care Program (Program). The parallel valuation would be in addition to the valuation completed by United Health Actuarial Services (the Program's consulting actuary). At the October 2006 meeting of the Committee, draft 2006 valuation results from both United Health Actuarial Services and Mercer (the parallel valuation) were presented. The results of the two valuations were similar and the Committee requested that the two actuarial consultants attempt to arrive at a "consensus" number for a rate increase for the Program.

Letters from both actuarial teams describing a consensus rate increase have been received by Audit Services and are included as Attachment 1. The result of the reconciliation effort was a proposed average rate increase of 33.6 percent. This increase would result in an estimated reserve of between zero and five percent based on underlying valuation results and specified assumptions regarding morbidity improvement and new business. Program staff provided the Long-Term Care Advisory Committee (Advisory Committee) with the results of the reconciliation effort.

Based upon the above referenced reports the staff's proposal for a mitigation strategy has been updated to reflect the consensus rate increase but otherwise remains unchanged (except as it deals with 2005 rates as noted below) from the material presented to the Board at the October 2006 meeting. Included is a presentation of competing "cross subsidization" (cross subsidization refers to rate plans that subsidize rates at older ages and increase costs to younger policy holders) scenarios with the rate increase spread across age groups and plan design.

Staff's proposal is based on the following assumptions:

- CalPERS does not have the ability to subsidize this Program with other business lines or financial reserves as do other Long-Term Care insurance carriers. The Program's premiums and investment earnings need to be sufficient to cover all Program costs and liabilities.

- The Program began at a point in time when the Long-Term Care insurance marketplace was relatively new and volatile.

- The Long-Term Care marketplace has matured, with many insurers leaving the market; the ones that remain, or are entering the market, are savvier and more financially viable with benefit designs and premium structures that are more stable.

- In recent years, new policy sales for this Program have been low but consistent with sales in the commercial Long-Term Care marketplace. The total number of policies-in-force has remained flat since the prior premium increase effective in 2003. Based upon this, the Program should not expect significantly expanded sales to cover the projected deficit.

- The CalPERS Board has approved two concepts to change the orientation of the Program; 1) build reserves and no longer rely on a "break-even" approach, and 2) reduce cross subsidization across products. A reserve is necessary to carry the Program through short term declines in investment income or spikes in claims experience. Limiting cross- subsidization is important to maintaining competitive rates across all ages and plan designs. Shifting costs predominately to one age group or plan design could significantly reduce the competitiveness of the Program and result in increased risk and increased claims costs.

- In order for CalPERS to compete on a level field with commercial carriers, the current risk pool would need to be segmented through two-party discounts (spousal), prime, average, and sub-average rates and other discounts and incentives linked to more restrictive underwriting.

- An expansion of market penetration (new sales) would require a substantial commitment of additional assets, including a real sales force (an agent network), as opposed to the marketing currently undertaken by the Program.

Staff Recommendation

Based on the rate history of the Program, the final results of the June 30, 2006, Valuation Report completed by United Health Actuarial Services (Attachment 2), the consensus rate increase of 33.6 percent, and analysis of comparative rates, staff recommends that the Program focus on ensuring there are adequate reserves to meet the demands of current in-force policies. Staff and the Program's consulting actuary propose premium rate increases (included in Attachment 3, Proposed Mitigation Plan) for all policies issued in calendar year 2004 and prior years as part of a comprehensive mitigation plan that would lead to more consistent projection results across all plans.

Reliance on the consensus rate increase of 33.6 per cent indicates that existing 2005 rates are adequate; thus staff has modified previous proposals and is not recommending any changes to the 2005 rates. The proposed increases are adequate to build reserves and reduce cross subsidization across plan design and age groups. This proposal aims to build Program reserves without placing increased costs burden or disincentives for younger or newer policy holders. With this rate increase, members will be allowed a one-time opportunity to choose between two options as an alternative to the rate increase:

1) The member can step back to a lower Daily Benefit Allowance (DBA), (with a waiver of the underwriting requirements and utilization of their age at issuance into the Program), or

2) Based on revised premiums, members can step back from the "lifetime" policy to a six-year (or shorter) term policy (with a waiver of the underwriting requirements and utilization of their age at issuance into the Program) if the premium under the rate increase is actually less for the six year, or shorter term, policy.

Claims experience for this Program and broader industry information indicate that for most members a lifetime policy represents an unnecessary cost and over-insurance. Overall, the implementation of this rate increase will bring in-force premium rates more in-line with 2006 rate levels.

Staff further recommends that this premium increase become effective on July 1, 2007, or the next available billing date for those members that are not billed on a monthly basis.

The Program's consulting actuary has provided rate increases that would be based on the following assumptions:

- Based on 2006 base case valuation results and targeting a zero to five percent margin (based on the Mercer analysis), the projected funding deficit as of June 30, 2006, is approximately 36.8 percent
- Spreading of rate increases with a one-time increase

- Continuation of the age adjustment (cross subsidization) rate increase used for the rate increase applied during 2003, but with additional smoothing across the age groupings. The age adjustment should be modified from that used in 2003 to narrow the range of adjustment and provide a higher minimum rate increase than occurred in 2003
- Accounted for the impact of future new business by assuming that the amount of new business realized in 2005 would continue for the next ten years
- Accounted for a 2.5 percent additional future morbidity improvement identified by the Long Term Care Group staff

A number of charts are included as part of the Proposed Mitigation Plan which explain the proposed rate increase. Within the Proposed Mitigation Plan Attachment 1 shows the transition from the results of the 2006 Valuation Report (a 36.8 percent deficit) to the proposed 33.6 percent rate increase. The Valuation results are adjusted to account for new business and improvement in morbidity assumptions.

Attachment 2 of the Proposed Mitigation Plan shows the resulting rate increase as an across the board increases without any cross subsidization. The fifth column from the left summarizes this rate increase for a one-time increase. The next two columns to the left show the same increase spread as a two-year increase.

Attachment 3 of the Proposed Mitigation Plan provides additional detail on the across the board rate increase with no cross subsidization. The chart provides both percentage increases by age and plan and corresponding dollar amounts for monthly increases. Information is provided on both one step and two step increases.

Attachment 4 of the Proposed Mitigation Plan provides percentage and dollar increase detail on the staff proposal. The rate increase shown in Attachment 4 includes a moderate amount of cross subsidization, but less than was applied to the previous rate increases effective in 2003. As with Attachment 3, the chart provides both percentage increases and dollar amounts for monthly increases under this proposal for both a one step and a two step increase.

Attachment 5 of the Proposed Mitigation Plan provides detailed information on percentage and dollar increases based on the proposal recommended by the Advisory Committee. This Advisory Committee recommends additional cross subsidization across age and plan design. A comparison of Attachments 4 and 5 show the cost increases that result for younger members as the cross subsidization is increased.

As indicated in the staff recommendation, staff does not recommend the degree of cross subsidization contained in the Advisory Committee recommendation. Staff feels that the moderate cross subsidization contained in Attachment 4 provides a balance between protection for older members without creating disincentives for younger members in the Program.

Attachments 6, 7, and 8 provide comparison rates for the Program with the estimated impact of the rate increases found in Attachment 3, 4, and 5. On an individual basis, the Program's rates generally remain competitive, but any pricing advantage tends to erode when the discounts available from other commercial carriers are applied. In additional, additional cross subsidization of rates clearly reduces the competitiveness of the Program's rates at the lower age groups. This lack of competitiveness increases the chances that younger members of the Program can find better rates in the commercial marketplace and leave the Program.

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Attachments